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# Ethics in Brief

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## The Current Economic and Financial Crisis: Where Are We Now?

Andrew Hartropp

**Introduction**

This article offers a very brief reflection on the problems regarding banks, the credit crunch, the consequent economic slowdown and recession in many countries, the need for public authorities to take rapid action, involving enormous sums of money, and the resultant added pressure on government finances worldwide. It addresses three questions. First, what has happened in 2007-10? Secondly, what are the causes? I will consider structural, policy and institutional aspects, and also underlying causes. Thirdly – and very briefly – what are the lessons and implications? It argues that three problems exist: the problem of explicit state guarantees for banks; the problem of global capitalism; and the problem of human sin. In other words, we will examine where we are, why we are here, and where we should go.

Before proceeding, a distinction must be drawn between a 'deficit' and a 'debt'. A *deficit* is the difference between the expenditure of a particular entity (such as a household) and the income of that entity. A deficit is measured over a given period of time, e.g. a year. In the case of the UK government, it currently has – as is increasingly well known – a large deficit: typically referred to as the 'budget deficit'. For the financial year 2009-10, the deficit was £156 billion.[1] By contrast a *debt* is the total amount owed by one entity (such as a household). A *debt* is thus the total of all accumulated *deficits*[2] : accumulated, that is, 'since time immemorial'. In the case of the UK, the total government debt, measured at the end of the 2009-10 financial year, was £893 billion.[3]

The problems facing us are severe. It is striking that the chief economic commentator of the *Financial Times*, Martin Wolf, writing about a year after the horrendous period in autumn 2008, warned of 'still more and bigger crises ahead'.[4] In the light of the near-panic in April and May 2010 regarding the economy and government deficit in Greece, then Wolf may not have been wide of the mark. The crisis is by no means over.

**A. What has happened in 2007-10?**

A great deal has happened, of course! In addition, the central empirical facts of what took place have been widely reported, and many of us are familiar with the shape of what has happened. Nevertheless it is worth offering a brief list of the key events and trends.[5]

**1. *Bank losses***

In the 2007-08 period, a number of banking institutions suffered losses on a very large scale. These losses related primarily to so-called 'sub-prime' mortgages in the USA – the (euphemistic) reference is to mortgages made available to borrowers whose ability to repay was lower than that of typical mortgage borrowers. In September 2008 these losses were estimated – by the IMF – to be $1.4 trillion. ($1 trillion is $1,000 billion: i.e. 12 zeros!) At the time of writing, the IMF's estimate is that total bank losses (realised and expected) for the 2007-10 period exceed $2 trillion.[6]

**2. *Bank failures***

A number of banking and other financial institutions fell, in the face of their losses and other problems. Such banks include Northern Rock in the UK (2007), and some German banks (also 2007). In the USA, Bear Stearns

collapsed in 2008, followed shortly by the government-sponsored mortgage lenders 'Fannie Mae' and 'Freddie Mac'.[7] All of the above institutions were rescued by their respective governments.

In September 2008, however, the Lehman Brothers investment bank (based in the USA) went bankrupt; *but* – a key point – Lehman was *not* rescued by the USA authorities. For Lehman to disappear was a huge shock to the financial system.[8]

**3. *Huge support for the financial system***

All over the world governments and governing authorities – including the central banks (in the UK, the Bank of England) – stepped in with huge and unprecedented amounts of funding to support the financial and banking system. As of April 2009, the IMF estimated the amounts of such support to be $8.9 trillion (trn): this comprised $1.9 trn in liquidity support, $2.5 trn in asset purchases, and $4.5 trn in guarantees.[9] To the extent that governments actually incurred expenditure for these programmes – as opposed to guarantees not yet taken up – then their actions were part of *fiscal* policy (defined below).

In addition to the above, interest rates worldwide were lowered – from what were already low levels, in historical terms. Interest rates became more or less zero, and so money was now effectively free: indeed, in *real* terms (i.e. adjusting for inflation) interest rates in general became *negative*. On top of these extremely low interest rates, the quantity of money flowing around the economy was radically boosted by some central banks – notably the Bank of England for the UK – by the tool known as *quantitative easing*.[10] Both of these two actions are aspects of monetary policy.

**4. *Severe impact of the financial crisis on real economic activity***

The financial crisis has undoubtedly had a major causal impact on the real economy. As is well known, there have in 2008-10 been deep recessions in many countries, large increases in unemployment, and also substantial falls in house prices. The consensus – at the time of writing, in mid-2010 – is that we are over the worst, but that the recovery is relatively slow, and is somewhat fragile.

Not all countries, however, have suffered recessions: and one country, in particular, has continued to see large increases in its economic output (as measured by its Gross Domestic Product, GDP). This country is China. Admittedly its economic growth rate (growth of real GDP) fell in 2008: but only to 9%! In other words, rather than growing at 12% (as it did in 2007), its growth slowed a little. Growth in 2009 was more than 8%, and its growth in the first quarter of 2010 was up to almost 12%.[11] In addition, China is not alone in having done relatively well over the past 2-3 years. For what are known as the group of 25 or so 'emerging economies' – comprising, amongst others, China, India, Brazil, Hungary, and Turkey – employment has actually continued to grow for almost all of this period.[12]

**5. *Huge fiscal stimulus***

In response to this adverse economic situation, the governments of the richest countries – especially the 'G20' countries – have sought to stimulate their economies by means of fiscal policy: increases in government spending, and cuts in taxes. The size of this G20 fiscal stimulus is the largest ever in peacetime, estimated at the equivalent of 2% of GDP in 2009, and 1.6% in 2010. In combination with the stimulus from monetary policy, this has made for a very considerable policy response, designed to pull these economies out of recession, and to avoid the recession turning into a much worse and prolonged depression. There is little doubt that these policies have had some significant positive impact, and that without them things would have been much worse.

The fiscal stimulus has, by definition, meant enormous increases in government deficits and debt, not least in the UK. As noted earlier, the UK government deficit for 2009-10 is £156 billion (approximately 11% of GDP), which has pushed the accumulated government debt up to £893 billion.

**B. What are the causes?**

Having seen where we are, it is now time to ask why we are here. Straightaway it must be acknowledged that the causes are complex, and that the degree of understanding by any human persons or agencies is necessarily less than complete.

This paper will simply and briefly draw attention to two sets of causal factors, without any claim to provide a full assessment of their relative importance or of the inter-relationships between any of them. We will first consider structural, policy and institutional factors concerning the operation of the financial and economic system; and secondly – and more briefly – consider some underlying causes in terms of moral values.

**1. *Structural, policy and institutional factors***

In terms of economic analysis, the starting point might seem surprising. Rather than beginning with the behaviour of the banks, I would argue that it is important to delve further back. So the first structural factor concerns *global economic imbalances*. Essentially, as the 21st century began to unfold, the USA and other

Western economies have been spending far more than they have been earning. This is so not only for the governments: the corporate and personal sectors have also been borrowing. So the USA in particular has been running an enormous deficit in its external trade. But from where have the funds come to finance all this? The answer is: from China, in particular, and also others of the 'emerging economies'.

China and the other emerging economies have been building up financial reserves – especially reserves held in the form of US dollars – on a very large scale. In other words, they have been *saving*, in enormous quantities.

This 'glut' of savings has led to two major developments in the West: 'sub-prime' lending and financial bubbles (unsustainable increases in the prices of financial assets and of property). These are inter-related. Part of the attraction of sub-prime lending/ borrowing was that, in the light of rising house prices, the risks of such lending and borrowing *seemed* to be low: houses could always (it felt) be sold at a profit, and hence mortgage loans could safely be paid off.

The argument is, then, that the sub-prime lending and financial bubbles in the West had their origins in the global economic imbalances. The explanation is now widely accepted. In turn, these global economic imbalances – the enormous trade surplus of China and others, and the huge trade deficit of the USA, in particular – had their own origins yet further back: in the liberalization of world trade and of markets, and especially the banking sector. [13]

A second structural factor has been *widespread financial innovation*. A whole range of 'asset-backed securities' were created. The thinking behind this 'securitization' process was that the risk implicit in any given mortgage contract, for example, could be sliced up and repackaged with similar slices from other mortgage contracts. Hence risk could be dispersed, and therefore *reduced*, via securitization. (The same kind of thinking lies behind 'credit default swaps' – the dispersion and thus reduction of risk.) In hindsight, all this has proved largely fallacious, as demonstrated by the enormous bank losses noted earlier.

Thirdly, then, *risk was banished to the sidelines*. Instead of being at the centre of financial transactions – as previously – it was now seen as a detail that was easily handled. All of this, moreover, was underpinned (as noted) by ongoing rises in the prices of assets.

**2. *Underlying causes: morality and attitudes***

Many commentators – and many of them not operating from a Christian or other 'faith' perspective – have argued that it is insufficient to see the causes of the crisis *merely* in structural or institutional terms. For example, the 'greed of bankers' has become commonplace in terms of explanations of what has happened. People have sought an understanding of deeper and underlying causes.

The Christian faith is well placed to recognise what greed is and to understand its significance. As the New Testament says, greed is idolatry (Col.3:5). An idolatrous attitude to money and wealth has clearly been present, if not dominant, in our economies for some while – and it is not restricted to bankers.

Thus, secondly, consumerism – underpinned to some extent by the philosophy that 'I shop, therefore I am' – must be recognised as part of the picture. The unprecedented 64 successive quarters of economic growth in the UK (1992-2008) depended to some degree on such consumerism; and this growth was closely tied in with the financial system, not least on a global scale, as we have already seen.

Related to this, thirdly, has been an emphasis on self-centredness rather than stewardship. The damaging impact on the environment – God's created order – of the kind of economic growth that we have been experiencing is now well known. But the root of this problem is that we have forgotten to see ourselves as stewards of God's world.

Note, finally, that the sinfulness revealed in the above factors cannot be dealt with by regulation. Regulation may well have a part to play in *limiting* and *mitigating* human behaviour and its damaging consequences, but Christians will argue strongly against any notion that regulation holds all the answers.

**C. What are the lessons and implications?**

Space constraints require that this final section is very brief. Three points can be made.

First, we must understand *the problem of explicit state guarantees for the banks*. We have witnessed open-ended guarantees for the banks, irrespective of their folly. This means there is state-insured private wealth and power.[14] The morality of this is most disturbing. And even at a pragmatic level it is disastrous: no normal profit-seeking business can operate without a credible threat of bankruptcy. Policy proposals are now circulating to deal with this problem – but the situation is by no means yet resolved.

Secondly, we must understand *the problem of global capitalism*. I am *not* advocating that capitalism has

totally failed, or that it should be replaced. A Christian case for global capitalism can still be made – if only on the basis that it is better than the alternatives! But the current crisis undermines the strength of that case. Therefore it must be recognized that asset and credit bubbles *are always foolish and dangerous*. Yet capitalism as we know it is prone to such bubbles. *That is the problem*. In turn, therefore, these bubbles must be halted – e.g. with the aid of monetary policy.[15] More generally we need a range of better safety features, to guard against what has now been exposed as – at best – a serious flaw.

Thirdly, and most fundamentally, we must understand the *problem of human sin*. The root problem truly is, as the Christian gospel states, sin and self-centredness, not the lack of regulation or even structural factors to do with securitization. It is this same gospel which also offers the fundamental solution: liberty and new life in Jesus Christ. We must, then, take this opportunity to call people to repentance and faith. And the church of God must therefore *model* a set of values which is sharply different to the world's idolatry: relationships not simply profit; stewardship not self-centredness; justice for the poor and needy; and, last but not least, we must, as the apostle Peter exhorts us (2 Pet.3:13), eagerly look forward to that 'new heaven and new earth: the home of righteousness'.

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1. Source: Office for National Statistics (ONS). Note that, for all economic and financial data, £1 billion equals £1,000 million.
2. In economists' parlance, a deficit is a measure of a flow (*over* a period of time), whereas a debt is a stock (measured *at* a particular point in time).
3. Source: ONS. If the deficit for the next 12 months were, for example, £200 billion, then the UK government debt at the end of *that* 12 month period would be £1,093 billion.
4. Source: *Financial Times*, 29 September 2009.
5. As one example of many accounts of what has happened, see Ray Barrell & E. Philip Davis, 'The Evolution of the Financial Crisis of 2007-8', *National Institute Economic Review*, October 2008. Their account (written in 2008) concerns, in particular, what turned out, of course, to be only the first phase of the crisis.
6. Source: IMF staff estimates.
7. These are the more familiar names of, respectively, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.
8. There is considerable debate concerning whether or not the authorities were right in this decision not to rescue Lehman. Again, however, this matter need not detain us.
9. Source: IMF.
10. This somewhat ugly term essentially means an expansion of the quantity of money, injected into the financial system by means of purchases of financial assets. It must be distinguished from the previously mentioned support which was offered *directly* to *specific* institutions.
11. Source: National Bureau of Statistics.
12. Source: Professor Valpy Fitzgerald, University of Oxford, Lecture on 21 May 2010, http://www.qeh.ox.ac.uk/pdf/pdf-misc/v_fitzgerald_lecture_1.pdf. Fitzgerald argues that these economies have adopted a more autonomous policy stance than in past crises, and that this has helped to protect them, to some degree, from the problems that originated in the advanced economies.
13. The details of that liberalization are well beyond the scope of this paper.
14. The contrast with the attitude towards the debts of heavily indebted *poorer* countries (HIPC) must be recognised. The total external debt of the very poorest countries (the 'low income countries' which have an annual average income of less than $935 per person) was US $222 billion in 2007 (source: www.jubileedebtcampaign.org.uk, accessed 24 May 2010). This is about *one tenth* of the total losses of the banks in the 2007-10 period. Yet the latter were bailed out instantly. The HIPC countries, by contrast, struggle on to try to pay off their debts.
15. There is now plenty of literature supporting such a proposal.

**For further reading**


- Stephen Green, *Good Value: Reflections on Money, Morality, and an Uncertain World*, Atlantic Monthly Press, 2010. [Mr Green is a Christian, and Chairman of HSBC.]
- Andrew Hartropp, *What is Economic Justice? Biblical and secular perspectives contrasted*, Paternoster, 2007.
- David Smith, *The Age of Instability: The Global Financial Crisis and What Comes Next*, Profile Books, 2010.
- Gillian Tett, *Fool's Gold: How Unrestrained Greed Corrupted a Dream, Shattered Global Markets and Unleashed a Catastrophe*, Abacus, 2010.



**Rev. Dr. Andrew Hartropp** is a church minister and an economist. He lectured in economics for five years at Brunel University, West London, and has doctorates in both Economics (University of Southampton) and Christian Ethics (King's College, London). He is Associate Vicar with three parishes in rural east Berkshire, and also a Research Tutor (Development Studies) at Oxford Centre for Mission Studies. He has published widely on topics in Christianity and economics, and is also a member of KLICE's Advisory Council.